

NATIONAL CONSUMER LAW CENTER'S REPORT

DESPERATE HOMEOWNERS:
LOAN MOD SCAMMERS STEP IN
WHEN LOAN SERVICERS REFUSE TO
PROVIDE RELIEF

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NATIONAL
CONSUMER LAW
CENTER®



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ABOUT THE NATIONAL CONSUMER LAW CENTER

The National Consumer Law Center®, a nonprofit corporation founded in 1969, assists consumers, advocates, and public policy makers nationwide on consumer law issues. NCLC works toward the goal of consumer justice and fair treatment, particularly for those whose poverty renders them powerless to demand accountability from the economic marketplace. NCLC has provided model language and testimony on numerous consumer law issues before federal and state policy makers. NCLC publishes an 18-volume series of treatises on consumer law, and a number of publications for consumers.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
I. INTRODUCTION	3
II. THE ROLE OF MORTGAGE SERVICERS: CUTTING COST, CUTTING SERVICE AND DRIVING BORROWERS TO FORECLOSURE RESCUE OPERATIONS.....	4
III. FORECLOSURE RESCUE SCAMS: FLOURISHING IN GOOD TIMES AND IN BAD.....	6
A. An Overview of Foreclosure Rescue Scams	6
B. Loan Modification: The Hottest Business Since Subprime Lending.....	8
IV. LOAN MODIFICATION FOR PROFIT.....	11
A. Who Are These Loan Modification “Experts”? The Same Salesmen Who Got Us Into This Crisis.	12
B. The Dangers of For-Profit Loan Modification Consultants Who Are Not Outright Scammers.....	14
C. What Else Are They Selling? Loan Mods That Turn Into Questionable Short Sales?	17
V. POLICY SOLUTIONS: WHAT SHOULD THE STATES, THE FEDERAL GOVERNMENT, AND COMMUNITIES DO?.....	19
A. What States Can Do.....	19
B. What the Federal Government Can Do	23
C. The Tricky Issue of Exemptions: To What Extent Should Attorneys, Real Estate Brokers and Other Licensed Entities Be Exempt?.....	27
D. Outreach & Enforcement	31
VI. CONCLUSION	32
Appendix A.....	34
Appendix B	36

EXECUTIVE SUMMARY

As the number of foreclosures continues to grow, a new “industry” has emerged seeking to profit from desperate homeowners who are trying to save their homes. For-profit loan modification services claim to help homeowners obtain changes in the terms of their mortgage loans that will make the loan more affordable and, thereby, help the homeowner save their home from foreclosure. Unlike older foreclosure rescue scams that seek to bilk homeowners of their equity, loan modification scams are more interested in homeowners’ spare cash. They make extravagant and unverifiable claims regarding their ability to help but too often the homeowner gets nothing after paying thousands in fees they can ill afford to spare.

While waiting for loan modifiers to deliver the promised relief, homeowners not only lose their money but may also fall deeper into default and lose valuable time that could have been spent negotiating directly with their mortgage servicer or by going to free a HUD-certified housing counseling agency with true expertise in avoiding foreclosure. For-profit loan modification companies are flourishing because mortgage loan servicers cannot or will not meet borrower need for assistance with their mortgages.

Protecting homeowners from loan modification and foreclosure rescue scams requires a unified effort by states, the federal government, and communities. So far, most homeowner protection activity has been at the state level. A number of states have enacted laws addressed to older versions of foreclosure rescue scams. Some of these laws can also be applied to loan modification scams. States can do more to protect homeowners by extending coverage of these laws to all homeowners regardless of whether the homeowner is in default and by tightening-up their exemptions. States lacking adequate protections should enact new laws with strong provisions that cover loan modification and other foreclosure rescue scams.

The federal government must also become more active in assisting homeowners. The Federal Trade Commission is currently taking comments on the need for regulations banning unfair and deceptive acts and practices in the loan modification and foreclosure rescue industry. The FTC should promulgate clear rules banning the industry from seeking

advance fees, requiring fees to be commensurate with the benefit actually provided to the homeowner, and prohibiting fees until the homeowner obtains an affordable, sustainable loan modification. The FTC's rules should establish a floor that will protect homeowners in states lacking adequate protections, but the rules should not preempt stronger state laws. The federal government could have the most impact by addressing the root cause of the problem: requiring mortgage servicers to offer an affordable loan modification if the homeowner qualifies *before* the servicer proceeds to foreclosure. Homeowners would not be driven to middlemen if they could get loan modifications directly from the only source with the power to give them.

Poor mortgage servicing has pushed many borrowers to seek assistance from loan modification companies, but the loan modification industry is complicit in fleecing financially distressed homeowners. States and the FTC must enact strong laws and regulations to protect homeowners from those preying on their distress.

I. INTRODUCTION

Homeowners facing foreclosure have always been vulnerable to scammers, con-artists, and thieves. Whether desperate for options or frustrated by uncooperative mortgage servicers, many homeowners are attracted to slick advertisements with bold promises to rescue them from foreclosure. When property values were appreciating rapidly, foreclosure rescue scams primarily focused on obtaining title to the home and robbing homeowners of their equity.¹ Today with property prices depreciating and many homes already “underwater,” equity is no longer the game.

Instead, rescuers have become high-volume, “loan modification specialists.”² The pitch by this new breed of predators is that, for a fee, which can reach several thousand dollars, they will negotiate a loan modification for a financially distressed borrower. The hitch is that the “work” performed, if any, leads nowhere, with the homeowner out money and time and closer than ever to foreclosure.

These loan modification companies are flourishing because mortgage loan servicers cannot or will not provide borrowers with timely and consistent information regarding their requests for loan modifications. Frustrated by the lack of responsiveness on the part of the servicers, borrowers across the country are giving loan modification companies their precious dollars with disastrous consequences.

¹ National Consumer Law Center, *Dreams Foreclosed: The Rampant Theft of Americans’ Homes Through Equity Stripping Foreclosure ‘Rescue’ Scams* (June 2005).

² “Loan modification scams” are just one subset of many that fall within the general category of “foreclosure rescue scams.” This report will use both terms.

II. THE ROLE OF MORTGAGE SERVICERS: CUTTING COST, CUTTING SERVICE AND DRIVING BORROWERS TO FORECLOSURE RESCUE OPERATIONS

The most obvious cause of the recent flood of foreclosure rescue scam operations is the foreclosure crisis. An estimated 8.1 million mortgages are anticipated to be in foreclosure within the next four years.³ These millions of desperate homeowners are a target too tempting for scammers to resist.

Beyond the numbers, however, foreclosure rescue scams are flourishing because those who actually are in a position to help—the mortgage servicers and the lenders on whose behalf they are acting—have done an inadequate job of working with homeowners. Despite widespread efforts to encourage voluntary loan modifications since early 2007,⁴ the servicing industry⁵ has failed to implement a loan modification strategy on a scale commensurate with the problem. Instead, it has become clear that the mortgage servicing industry is fundamentally broken when it comes to meeting the needs of borrowers.

As with all businesses, servicers add more to their bottom lines to the extent they can reduce expenses. Servicers have cut costs by relying more on voice mail systems and less on people to assist borrowers, by refusing to respond to borrowers' inquires, and by failing to resolve borrower disputes. Recent industry efforts to “staff-up” loss mitigation departments have been woefully inadequate.

³ Credit Suisse, *Foreclosure Update: Over 8 Million Foreclosures Expected* at 3 (Dec. 4, 2008).

⁴ For example, In May 2007, Senate Banking Committee Chairman Dodd announced a set of servicing principles aimed at long-term affordability. Those principles called, in part, for loan modifications that would “create a solution for the borrower to ensure that the loan is sustainable for the life of the loan.” Senator Dodd Unifies Industry Members, Consumer Representatives to Help Preserve the American Dream of Homeownership (May 2, 2007), <http://dodd.senate.gov/index.php?q=node/3863/print>. In June 2007, Chairman Sheila Bair of the FDIC called for automatic loan modifications for borrowers with subprime ARMs.

⁵ Servicers are generally responsible for account maintenance activities such as sending monthly statements, accepting payments, keeping track of account balances, handling escrow accounts, calculating interest rate adjustments on adjustable rate mortgages, reporting to national credit bureaus, and remitting monies to the owners of the loans. Servicers also are responsible for engaging in loss mitigation activities and prosecuting foreclosures.

From the homeowner's perspective, one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Stories abound of exasperated homeowners attempting to navigate vast voice mail systems, being bounced around from one department to another, and receiving contradictory information from different servicer representatives.⁶ For example, an October 2007 survey from the Neighborhood Housing Services of Chicago found that "countless counselors shared stories of having a client in the office ready to begin dealing with long-deferred financial problems, but then having to wait 30 minutes or more in order to talk to an appropriate loss mitigation staff person."⁷ Unfortunately, things have not improved as servicers struggle to keep up with the increased workload caused by the foreclosure crisis.⁸

The Chairwoman of the House Subcommittee on Housing and Community Opportunity, Congresswoman Maxine Waters, has demonstrated the difficulties faced by borrowers attempting to obtain a loan modification by making calls to servicers on behalf of three constituents.⁹ In one call to Bank of America it took ten minutes to get a live person on the line, then the Congresswoman was transferred to another department, put on hold and eventually disconnected. This is a common fate according to her constituent, who noted that he had been repeatedly disconnected in prior attempts to contact the servicer. After two hours and three additional calls to Bank of America's call center, Congresswoman Waters still was unable to make much headway. The Congresswoman concluded that, "the average American trying to get through to negotiate a loan modification will not be able to get it done."¹⁰

⁶ See, e.g., Gretchen Morgensen, *Can These Mortgages Be Saved?*, N.Y. Times (Sept. 30, 2007) (describing one homeowner who identified 670 calls relating to her home foreclosure in the previous three months and who received nine different answers about how best to proceed from 14 different people at the company); *Miller v. McCalla*, Raymer, 214 F.3d 872, 875 (7th Cir. 2000) (describing the process of trying to get through to an 800 number as a "vexing and protracted undertaking").

⁷ Neighborhood Housing Services of Chicago, Inc., *Lessons from the Front Lines: Counselor Perspectives on Default Intervention* at 6 (Oct. 29, 2007).

⁸ See Kate Berry, *The Trouble with Loan Repayment Agreements*, American Banker (Jan. 9, 2008) (noting that servicers push repayment plans instead of modifications because they "need twice the staff, and in part they can't manage the volume").

⁹ ABC Nightline, *Congresswoman on Hold on Bank Helpline: Homeowners' attempts to fight foreclosure are hampered by bank call centers* (Jan. 22, 2009), <http://abcnews.go.com/video/playerIndex?id=6704983>.

¹⁰ *Id.*

The servicing industry's unresponsiveness to borrowers' inquiries and its inability to provide timely and consistent information to borrowers is driving desperate homeowners into the outstretched arms of loan modification scammers. "Loan modification firms say they are taking up the slack left by unresponsive lenders and overwhelmed nonprofit groups."¹¹ If a homeowner is consistently disconnected or cannot wait on hold for 30 minutes because she has only a 15-minute work break, maybe \$1000 is not too much to pay for a chance to save her home. If a homeowner can't find his way out of the voice mail maze, maybe paying someone who can (or who claims to have special connections) seems like money well spent. While poor mortgage servicing has left borrowers flailing and looking for a lifeline, the loan modification industry has been perfectly happy to provide borrowers with cement life jackets.¹²

III. FORECLOSURE RESCUE SCAMS: FLOURISHING IN GOOD TIMES AND IN BAD

A. An Overview of Foreclosure Rescue Scams

Foreclosure rescue scams are not new. California passed a law to specifically address foreclosure rescue operations in 1979. By 2005, at the height of the housing boom, the scams were prevalent enough that the National Consumer Law Center (NCLC) published a report, "Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure 'Rescue' Scams."¹³

These scams revolve around heavily-promoted deals supposedly designed to save the homes of people who have fallen behind on their mortgage payments and face foreclosure. But with frightening regularity, "help" from "rescuers" drains off homeowners' scarce funds or built-up equity. In some cases, "rescuers" are left owning the houses – and families are eventually evicted from their homes. It is hard to escape the conclusion that such outcomes are exactly what the "rescues" are designed to achieve.

¹¹ Renae Merle, *Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say*, Washington Post at A01 (Dec. 26, 2008).

¹² Jay Macdonald, *Debtor, Beware, Mobile Register*, at J1 (Aug. 7, 2005) (noting foreclosure "rescuers" offer "what Harvard Law School professor and bankruptcy expert Elizabeth Warren calls 'the cement life jacket'.")

¹³ Available at <http://www.nclc.org/issues/foreclosure/index.shtml>

NCLC's 2005 report described three varieties of foreclosure rescue scams. The first is "phantom help," where the "rescuer" charges outrageous fees either for light-duty phone calls and paperwork the homeowner could have easily performed, or on a promise of more robust representation that never materializes. Victims of phantom help are inevitably left without enough assistance to save their homes, without the funds diverted to the rescuers, and without time to pursue other options by the time they realize the rescue has not materialized. The "rescuer" essentially abandons homeowners to a fate that might well have been prevented with better intervention.

A second variety of the scam is the sale/leaseback that never quite works. This scenario includes various schemes under which homeowners surrender title to their houses in the belief that they are entering deals where they'll be able to remain as renters, and buy their homes back over the next few years. Homeowners are sometimes told that surrendering title is necessary so that someone with a better credit rating can secure new financing to prevent the loss of the home. But the terms of these deals are almost invariably so onerous that the buyback becomes impossible, the homeowner permanently loses possession, and the "rescuers" walk off with all or most of the home's equity. In some cases, the homeowner's mortgage is paid off, in others it is not—despite a due on sale clause—and the homeowner remains on the hook if the rescuer fails to make payments.

The third variety is a bait-and-switch where the homeowners ***do not realize*** they are surrendering ownership of their houses in exchange for a "rescue." Either the sale documents are forged or the homeowners are led to believe that they are only signing documents for a new loan to make the mortgage current. Many also say they had made it quite clear they had no intention of selling or giving up their home to anyone. Further evidence that homeowners have been gulled by this variant of the scam is the many cases in which the home is transferred for a ridiculously small fraction of its actual value.

Today, with homes much more likely to be upside down than to have equity worth stealing, equity stripping scams are less prevalent. "Phantom help," however, has taken off, under a new name: "loan modification specialists."

B. Loan Modification: The Hottest Business Since Subprime Lending

Before the real estate market collapsed in 2006, there was no “loan modification industry.” Today, the loan modification industry is booming. By the summer of 2007, the Better Business Bureau reported receiving complaints from hundreds of homeowners in all 50 states who had each paid up to \$1,300 to con artists promising help but doing little or nothing.¹⁴ A little more than a year later, the State of California was receiving an average of 900 complaints per month with 175 active investigations—and that was just about scams involving attorneys.¹⁵ A March 2009 survey showed 61% of California housing counselors reported it to be “very common” for homeowners to have a bad outcome with for-profit loan modification services.¹⁶

Advertising is all over TV, often late at night. It is on prime-time radio in English and Spanish as well as on the internet. It is in newspapers, on street flyers, signs and billboards, and on other direct mail solicitations.¹⁷ A recent press release for JCR Advertising announces the national launch of an infomercial produced exclusively for loan modification companies.¹⁸ The infomercial, entitled *Crisis on Main Street*, highlights news clips from Obama, Bush, Bernanke, McCain and others to provide “credibility to the campaign.” Saturation marketing, often laced with lies and exaggerations, plays on the desperation and trust of distressed homeowners. In May 2009 the Texas attorney general filed suit to shut down a foreclosure rescue firm using “high pressure sales tactics and false ‘guarantees’” of the firm’s ability to save homes “in order to extract large cash payments from

¹⁴ Better Business Bureau, *Mortgage Foreclosure Scams on the Rise, Warns BBB: Foreclosure “Rescue” Companies May Promise to Save Your Home, but Only Empty Your Wallet* (Aug. 17, 2007), www.bbb.org/us/article/968.

¹⁵ Testimony of Scott J. Drexel, Chief Trial Counsel, State Bar of California, Before the Subcommittee on Housing and Community Opportunity of the committee on Financial Services of the United States Senate Regarding Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud at 2-3 (May 6, 2009).

¹⁶ California Reinvestment Coalition, *The Ongoing Chasm Between Words & Deeds V: Abusive Practices Continue to Harm Families & Communities in California* at 8, 23 (survey of non-profit housing counselors and legal services attorneys serving 14,796 consumers in Mar. 2009).

¹⁷ See Alyssa Katz, *Predatory Lending With a Smiley Face* (Mar. 3, 2004), http://www.salon.com/news/feature/2009/03/04/loan_modifications/ (describing loan mod company that “blitzes homeowners who have subprime loans and other high-risk mortgage with junk mail and telemarketing calls”).

¹⁸ See JCR Advertising Press Release, *Crisis on Main Streets Delivers Big on Over 200 Stations Across the Country* (Jan. 15, 2009), <http://www.mortgagemag.com/news/2009/0101/1000010033070.htm>.

homeowners.”¹⁹ These are the same marketing practices that were used to sell the abusive loans that scammers now seek to modify.

Loan modification operators have seized on press reports about legitimate government and industry loan modification programs and publicity about millions of dollars of bailout money available. One website has bold red letters: “\$75 Billion Released in Government Funds.”²⁰ Homeowners who do not see any of that money trickling down to them, and who cannot get through to their servicers, are receptive to claims that an “expert” can help them cut through the red tape.

Often companies represent themselves as being affiliated with the government.²¹ Many have adopted names that imply a government connection. The ad for “USHUD.com” claims to be “The name you know, the name you trust.”²² The Federal Trade Commission has issued cease and desist orders to several companies with deceptive names or websites, including “Federal Loan Modification,” “Bailout.hud.gov.us,” and others that trade on the legitimate Hope Now industry program, such as “Hope Assure,” “Hope Now Modifications,” “New Hope Property,” and “New Hope Modifications.”²³

Most loan modification scams involve taking up front payments and doing little or nothing for the homeowner. However, other variations on this theme have also been reported:

- Charging a fee to obtain an unaffordable loan modification;
- Charging exorbitant fees to homeowners attending loan modification seminars;²⁴

¹⁹ The scheme was launched in November 2008 when its principals incorporated Excel Loss Mitigation – even though they had “no legitimate business model, resources, or plan to actually perform any services that would help the homeowners,” the lawsuit says. From its Houston office, Excel solicited business – and upfront fees of \$1,498 each – from homeowners in its home state and in Florida, Nevada, California, Ohio, Michigan, Louisiana and other states. See press release and documents posted on-line at www.oag.state.tx.us/oagNews/release.php&id-2983.

²⁰ See <http://www.ushud.com/loanmodification.html>.

²¹ See John Leland, *Swindlers Find Growing Market in Foreclosures*, New York Times at A1 (Jan. 15, 2009).

²² See <http://www.ushud.com/loanmodification.html>.

²³ See Press Release, *Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams*, Federal Trade Commission (Apr. 6, 2009), <http://www.ftc.gov/opa/2009/04/hud.shtml>.

²⁴ Michale Doyle, *Claims to fix mortgages for fee set off red flags for the feds and Cardoza*, Modesto Bee (Oct. 25, 2008), <http://www.modbee.com/local/story/475093.html> (homeowners charged \$3500 to attend workshop to resolve delinquent mortgage problems).

- Charging thousands of dollars for “loan audits” by non-attorneys who claim to discover legal defects in the mortgage, but which are worthless because the defects don’t exist or the potential violations are barred by a statute of limitations which has expired.

Regardless of the form they take, the bottom line is typically that the homeowner pays thousands of dollars and gets nothing in return. Here are a few recent news accounts:

- Queens, NY – The Middleton family with a young daughter battling cancer pays American Modification Agency \$1990 to renegotiate their mortgage loan. The company told the Middletons to stop making mortgage payments and promised a loan modification with lower payments. When the loan modification never materialized, the Middletons found themselves further behind, and their home was scheduled for foreclosure.²⁵
- Chicago, IL – Ms. McClelland paid \$1,300 to Foreclosure Solutions Experts to stop the foreclosure on her home and reduce her mortgage payments. Despite being told repeatedly by the company that she did not have to worry about anything, the company failed to contact her lender.²⁶
- Alexandria, VA – A 75-year old retired nurse paid \$2,500 to U.S. Homeowners Assistance for help in modifying her loan. After taking her money, the company failed to return her calls and her home fell into foreclosure.²⁷
- Parker, CO – The Monsons paid Peoples First Financial \$3,000 to keep their home out of foreclosure. The company told them not to talk to their mortgage servicer and not to make mortgage payments “so it would be easier to renegotiate.” The company did nothing and the house is in foreclosure.²⁸

²⁵ Daniel Massey, *No Helping Hand*, Crain’s N.Y. Business (Jan. 10, 2009),

<http://www.craigslist.com/article/20090111/FREE/301119975/rss22>.

²⁶ John Leland, *Swindlers Find Growing Market in Foreclosures*, N.Y. Times, at A1 (Jan. 15, 2009).

²⁷ Renae Merle, *Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say*, Washington Post at A01 (Dec. 26, 2008).

²⁸ John Rebchook, *Loan modification firms causing more problems for homeowners*, Rocky Mountain News (Dec. 24, 2008), <http://www.rockymountainnews.com/news/2008/dec/24/loan-modification-firms-causing-more-problems/>

- Watsonville, CA – The Mendez family responded to a Spanish radio ad from Saving California, a company that promised to lower the Mendez’ mortgage payment. Two months after paying \$3500 to the company their bank had not been contacted regarding a loan modification for the Mendez family.²⁹

These stories represent just the tip of the iceberg. For too many families, loan modification scams make a precarious financial situation much worse. Homeowners are out thousands of dollars that could have been put towards their mortgages. Some fall further behind on their payments after loan modification companies advise them to stop making mortgage payments or to stop calling their loan servicer.³⁰ And, the foreclosure clock keeps ticking as borrowers wait for these companies to make good on their promises.

IV. LOAN MODIFICATION FOR PROFIT

Many loan modification and foreclosure rescue operations are run by scammers who have no intention of doing anything other than stealing the homeowner’s money. But this raises the question of whether legitimate loan modification operations exist. Certainly the need is real because of servicers’ inadequate response to the foreclosure crisis. Though the free services offered by HUD-approved housing counseling agencies are unquestionably the first and best option for struggling homeowners, these counselors are overwhelmed and some homeowners report difficulties in getting through to them. For some homeowners, it would be well worth \$2,000 or \$3,000 to obtain an affordable loan modification that enables the family to save the home.

²⁹ Anna Werner, *Loan Modification Firms May Not Always Be Helpful*, CBS5 (Jan. 30, 2009), <http://cbs5.com/local/foreclosures.loan.modification.2.922003.html>.

³⁰ See, e.g., Daniel Massey, *No Helping Hand*, Crain’s N.Y. Business (Jan. 10, 2009), <http://www.craigslist.com/article/20090111/FREE/301119975/rss22>; Press Release, “Brown Announces Arrest of Two Scam Artists Who Committed Loan Modification Fraud,” Cal. Attorney General (Mar. 19, 2009) and attachments, <http://ag.ca.gov/newsalerts/release.php?id=1702> (advised homeowners against paying mortgage or contacting servicer); California Reinvestment Coalition, *The Ongoing Chasm Between Words & Deeds V: Abusive Practices Continue to Harm Families & Communities in California 22-23* (July 2009) (46% of housing counselors report “very common” for borrowers to say they were told not to contact servicer), <http://calreinvest.org/system/assets/195.pdf>; Modifications Loan LLC, <http://www.modificationsloan.com> (FAQ advising homeowners to make payments late in order to pay for loan modification services).

The problem with asking about legitimate, for-profit operations is the large gray area of entities that are not outright scammers but which may not be working hard enough to get a good modification, and, even if they are working hard enough, still fail to do so too often. Ultimately, regardless of whether a transaction began as a scam or is merely unsuccessful, the for-profit loan modification industry inflicts enormous damage on homeowners who pay thousands of dollars, lose valuable time and money, and get nothing. Therefore, even assuming there is a legitimate, for-profit industry, tough regulations and prohibitions are necessary because, overall, for-profit loan modification services do more harm than good regardless of their motivation. The real question is how far backwards lawmakers should bend to protect this industry.

A. Who Are These Loan Modification “Experts”? The Same Salesmen Who Got Us Into This Crisis.

Some have called the upstart loan modification industry the hottest business since subprime lending. Ironically, mortgage brokers and other real estate professionals, who saddled borrowers with unsustainable home loans, are now reaping more profit from the same borrowers by promising to fix their bad loans.³¹

Indeed many loan modification companies have connections to the defunct subprime mortgage industry. For example, USMAC, which charges clients a non-refundable fee of \$3,495 to negotiate a loan modification, is owned, in part, by the president of Citywide Mortgage, a former subprime lender.³² Mortgage brokers—often cited as one of the driving forces in the growth of bad subprime loans—are in demand to work for loan modification companies.³³ For example, the Nationwide Foreclosure Prevention Center in Williamstown, NJ is looking for consultants with mortgage and real estate experience to join its cadre of loan modification specialists.³⁴ Its classified ad urges consultants to “Tap Into The Lucrative

³¹ See Alyssa Katz, *Predatory Lending With a Smiley Face* (Mar. 3, 2004), http://www.salon.com/news/feature/2009/03/04/loan_modifications/.

³² Robert Berner, ‘Help’ Can Be Costly, *Business Week* (Nov. 11, 2008).

³³ See Alyssa Katz, *Predatory Lending With a Smiley Face* (Mar. 3, 2004), http://www.salon.com/news/feature/2009/03/04/loan_modifications/ (describing the Loan Processing Center which recruits mortgage brokers from across the country to join the operation).

³⁴ See National Foreclosure Prevention Center, available at <http://www.ceasemyforeclosure.com/affiliates.php>.

Loan Modification Industry” and suggests that consultants could earn up to \$100k or more this year counseling troubled homeowners who are delinquent on their mortgage or facing foreclosure. The ad notes that “Only strong CLOSERS NEED APPLY!”

Another internet ad says, “LAW FIRM SEEKS STRONG CLOSERS FOR LOAN MODIFICATIONS. Each seat is worth GOLD!!!! ... A realistic earning potential in the 200’s in today’s market.” Among the skills and qualifications sought: “Few months Modification experience is preferred or ‘Mortgage Refinance’ heavy hitter in the past... No Real Estate License Required **The ability to Sell (This is a sales role)**” (emphasis added).³⁵

Another company advertising for loan modification consultants has taken out ads with pictures of expensive cars. One ad implies that the consultants will earn enough to buy a \$200,000 Lamborghini.³⁶ Another ad features the \$1 million plus Bugatti Veyron.³⁷ Sometimes these sales people work off of lists of homeowners who are 30, 60 or 90 days late on their mortgages, sold by lead generators who charge anywhere from a few cents to \$20 or more per name, depending on whether the name is being sold exclusively to one firm or to several. The lead generators also emphasize that their leads are offered to sales people. One boasts, “This is the best file for direct mail, telemarketing, or voice broadcasting.”³⁸

In some cases, the people offering to save homes are convicted criminals. Consider Foreclosure Freedom, a loan modification firm created by two felons who had met in federal prison.³⁹ Foreclosure Freedom found desperate homeowners by paying \$50 a month for a subscription to an on-line service called foreclosures.com, and in a seven-month period that ended in January 2008 convinced more than 160 victims to give them a total exceeding \$158,000. A similar firm charged homeowners up to \$5,500 in advance fees, claiming to have a 100% success rate in saving homes from foreclosure.⁴⁰ The man responsible for the

³⁵ See <http://www.postjobfree.com/Job.aspx?id=7d2c6c681abd416a9dad4e66400ddea9>

³⁶ See http://lasvegas.backpage.com/MiscJobs/work_from_home_loan_mod_sales_reps_needed_7_000_per_month_from_home_/classifieds/ViewAd?oid=1228365

³⁷ http://allcrs.newsreview.com/gyrobase/loan_modification_consultants_work_from_home_live_transfer_and_direct_response_leads_/classifieds/ViewAd?oid=1465704

³⁸ See <http://www.globalmatrixleads.com/loan-modification-leads/>

³⁹ See news release and documents posted on-line at <http://ag.ca.gov/newsalerts/release.php?id=1702&>

⁴⁰ “FTC Charges Foreclosure Prevention and Loan Modification Marketers with Contempt,” June

scheme had previously been convicted of mail fraud in connection with another scheme offering work-at-home medical billing opportunities.

The conclusion appears inevitable that these operations are set up primarily to profit from the distress of others (and to attract those whose motivation is greed), not to perform a real service. Why else would these companies need “strong closers” who are skilled at pressuring reluctant homeowners into buying the alleged services they are selling?

B. The Dangers of For-Profit Loan Modification Consultants Who Are Not Outright Scammers

Assume for the sake of argument that some of the companies advertising loan modification assistance are not simply out to take homeowners’ money, but are engaged in actual attempts to modify the loans. Is this a business that policymakers should encourage?

The loan modification business has striking similarities to, and really is a variation of, the debt settlement industry. In fact, some loan modification firms *are* debt settlement companies.⁴¹ As Travis Plunkett of the Consumer Federation of America recently testified to Congress, the debt settlement industry’s business model is inherently harmful to vulnerable consumers. The highlights of his testimony are equally applicable to for-profit loan modification consultants, who also:

- Often mislead consumers about the likelihood of reducing their debt/loan;
- Cannot guarantee that creditors will agree to a reduced payment if certain conditions are met;
- Often mislead consumers about the effect of the process on their credit worthiness;
- Charge such high fees that consumers have little chance of benefiting;
- Often will only work with the consumers in the most serious distress, who are the least likelihood to have a favorable outcome, and encourage consumers to put themselves in distress as a condition of helping them; and

10, 2009 release from the FTC, posted on-line at www.ftc.gov/opa/2009/06/medicalcapital.shtm

⁴¹ See, e.g., <http://www.thinkdebtrelief.com/>.

- May do nothing until the firm's fees are paid in full.⁴²

The most obvious problem is that homeowners in distress are paying a substantial amount of money, and losing valuable time waiting for help to arrive, without any guarantee that it will. **At the end of the day, from the homeowner's perspective, there is no difference between a company that takes her money and runs off with it, and one that takes it, makes some futile attempts, and says, "sorry, we tried, but you can't have your money back."**

Even assuming the most diligent efforts by the consultant, success against unresponsive servicers is likely to be just as elusive as it is for homeowners who try on their own, but far more expensive.⁴³ Less diligent consultants, who are more interested in earning that promised \$200,000 salary than wasting a lot of time on a hard case, are likely to give up and move on to the next case. Claims of a high success rates seem inherently suspect because there are few (if any) public statistics available to verify these claims.

It is also useful to put this discussion in the context of the loan modifications that servicers are actually offering. Even the lucky few consumers who can get through to their servicers and actually get loan modifications are not out of the water. The latest numbers⁴⁴ for modifications made in March 2009 show that only 15% reduced the interest rate or the principal. Only 55% even reduced payments (most likely by stretching out the amortization schedule with a balloon payment at maturity). That is, 45% either *increased* payments or left the amount untouched. For the few who got write-offs of loan principal, the write-offs averaged 13%. This contrasts with a loss rate of 64% for loans that went to foreclosure. Of the loan modifications made to date, about 50% have re-defaulted.⁴⁵

⁴² See Testimony of Travis B. Plunkett Before the Committee on Commerce, Science, and Transportation of the United States Senate Regarding Consumer Protection and the Credit Crisis at 8-10 (Feb. 26, 2009).

⁴³ See Peter S. Goodman, Paper Avalanche Buries Plan to Stem Foreclosures, N.Y. Times, June 29, 2009, at A1 (describing loan modification service that charges \$3,000 up-front but is often thwarted by unresponsive servicers).

⁴⁴ Prof. Alan White, *February and March Foreclosure Trends*, Consumer Law and Policy Blog (Apr. 8, 2009), <http://pubcit.typepad.com/clpblog/2009/04/february-and-march-foreclosure-trends.html>.

⁴⁵ See Emily Flitter, *Rising Redefaults Raise Loan Mod Mandate Odds*, American Banker at 1 (May 5, 2009).

These abysmal numbers are worth keeping in mind when deciding whether it is worth encouraging an industry that charges \$2,000 to \$4,000 to the homeowner and cannot even guarantee any sort of loan modification. Moreover, the loan modifications obtained by for-profit firms are likely to be worse than the average. Unlike a non-profit HUD-approved housing counseling agency, a for-profit loan modification consultant has an incentive to push the homeowner into taking the first modification offered, or to refuse to push for more, even if it offers little chance of actually saving the home.

Many loan modification firms give advice that can be damaging to homeowners, encouraging those who are not yet in default on their loans to become so. The advice may be direct, or the firm may tell homeowners that they cannot help them unless and until they are in default. As in the case of debt settlement companies, one has to wonder whether this posture is intended solely for negotiating purposes or whether the firm is also trying to free up resources to pay the firm's fees.

Finally, the substantial advertising spent to promote these firms obscures the message that homeowners are much better off taking advantage of the free, well-qualified help available from HUD-approved housing counseling agencies. One website, USHUD.com, even claims to be: "America's Only **Free** Foreclosure Resource." Some loan modification firms tout their expertise,⁴⁶ yet there is no way for homeowners to verify whether these self-proclaimed experts offer anything worth paying for. As discussed above, the primary experience appears to be expertise at selling mortgage products.

By contrast, HUD-approved housing counseling agencies must be non-profit, IRS 501(c)(3) corporations, must complete the HUD approval process, and need to comply with HUD regulations, including requirements for trained, experienced staff. These regulations include conflict of interest provisions that require counselors to act in the best interest of their clients, quarterly reporting to HUD of performance numbers, biennial site visits and review of client files, restrictions on charging fees, and record-keeping requirements. The non-profit housing counseling industry has extensive foreclosure training programs, provided by NeighborWorks, National Council of La Raza, and HUD, along with internal

⁴⁶ See, e.g., www.newteamloanmodification.com/; www.serviceloanmodification.com/.

training programs provided by ACORN Housing, National Foundation of Credit Counseling, Money Management International and others.⁴⁷ And all that for free.

HUD and the agencies it funds have made serious investments in the training of counselors. Allowing scammers to undermine their efforts is also working against federal investments.

C. What Else Are They Selling? Loan Mods That Turn Into Questionable Short Sales?

Information is beginning to surface about a new variety of foreclosure rescue involving the sale of a house that is upside down (that is, more is owed on the house than is worth). Indeed, some loan modification websites tout their expertise in short sales.

A true short sale is one where the lender agrees to take less than the full amount of the loan in order to clear the title and permit the sale to proceed. As long as the lender is part of the process and everyone knows and agrees to the true sale price and the ramifications of a short sale, there is nothing unlawful about a short sale. Like a foreclosure, however, it has an impact on the homeowner's credit report. The lender may also insist that the homeowner remain liable for the deficiency, or even if it is forgiven, the homeowner may owe taxes on the forgiven amount. The same issues would arise if the lender permitted a new buyer to assume the mortgage.

In one version of a short sale scam, the realtor and the buyer collude to conceal the full price of the sale from the lender so that they can pocket the difference, often by using option contracts and back-to-back closings. This version is aimed primarily at defrauding the lender, though the homeowner is also hurt by an artificially low sales price, either by being liable on a deficiency or by paying taxes on a higher forgiven balance.⁴⁸

⁴⁷ The National Consumer Law Center subcontracts with National Council of La Raza to provide trainers at training conferences for housing counselors.

⁴⁸ See Nick & Cindy Davis, *Sellers Beware of Short Sale Scams* (Apr. 21, 2009), <http://www.city-data.com/blogs/blog5708-sellers-beware-short-sale-scams.html>; Bill Gassett, *Short Sale Scammers We Buy Houses* (Aug. 14 2008); <http://metrowestmarealestate.blogspot.com/2008/08/short-sale-scammers-we-buy-houses.html>; *New "short sale" scam taking root?*, St. Petersburg Times (April 22, 2008), <http://blogs.tampabay.com/realestate/2008/04/new-short-sale.html>.

In another version of a short sale scam, the buyer takes over the mortgage without satisfying the due-on-sale clause and the sale is concealed from the lender.⁴⁹ The owner of a We Buy Houses franchise explained at trial that these deals work when the homeowner is only 10% to 15% upside down, because the home is sold to a buyer who cannot qualify for a regular loan and so is willing to pay a premium above fair market value to avoid a credit check.⁵⁰ Depending on how the transaction works, the homeowner may be out cash, lose the home, and still end up with a foreclosure on the credit report.

Even assuming that this scheme works for the buyer, whose name is not on the mortgage and whose credit is not at risk, the perils for the homeowner are great. The homeowner remains on the hook for the mortgage if the buyer defaults, risking both a foreclosure on the record and potential liability for any deficiency. Default by the new buyer may be likely, because the buyers that these deals attract are ones who want to avoid a credit check and a substantial down payment. That is, they are seeking the type of no doc/no money down loan that contributed to the foreclosure crisis and is no longer available from regular lenders. The homeowner is also exposed to any other liability, civil or criminal, that comes with violating the due-on-sale clause and actively concealing that sale.

These transactions may begin as traditional loan modification contracts, in which the homeowner pays a fee in the hopes of saving the home. The rescuer may then pressure the homeowner into agreeing to the sale—and into paying a sales commission to the rescuer. Thus, the homeowner has to pay two fees, loses the home, may still have her credit

⁴⁹ An article appearing on several real estate investing websites explains how the due on sale clause is avoided. “The game for us is how to transfer ownership to the property without getting caught by the lender.” Attorney William Bronchick, *There's No "Due on Sale" Jail*, <http://www.legalwiz.com/due-on-sale-clause>. That article, which pre-dates the foreclosure crisis and the loan modification explosion, explains a scheme in which the property is first transferred to an *inter vivos* trust in the name of the original homeowner, with that homeowner as a beneficiary. That transfer is exempt from the due-on-sale clause under federal law *as long as there is no change in occupancy*. But then, “Sammy Seller quietly assigns his interest under the trust to you [the buyer] (similar to a transfer of stock in a corporation). This assignment is not recorded in any public record. *Sammy moves out and you move in*” (emphasis added). The article—which is aimed at investors, not homeowners—addresses the risks that the parties could be held liable for fraud or other criminal liability, or for civil liability, argues that the risks are not great, and concludes that the transaction “is a risk versus reward gamble.”

⁵⁰ Reporters Transcript, Adversary Proceeding at 35-46, *In re Michelle Perry*, No. 08-26905-C-7, (*Nunes v. Perry*, Adversary No. 08-2463), U.S. Bankruptcy Court (E.D. Cal. Feb. 11, 2009) (on file at National Consumer Law Center).

blemished by a foreclosure if the new buyer defaults, and may be exposed to liability for violating the contract.

V. POLICY SOLUTIONS: WHAT SHOULD THE STATES, THE FEDERAL GOVERNMENT, AND COMMUNITIES DO?

Protecting homeowners from loan modification and foreclosure rescue scams requires a unified effort by states, the federal government, and communities. This includes adequate legislation, vigorous enforcement, public education, and more funding for HUD-certified housing counselors and similar initiatives.

A number of states have enacted laws that, while adopted when somewhat different “phantom help” foreclosure rescue scams predominated, can be applied to loan modification scams and address some of the core problems. Not all states have these laws though, and many of the existing laws need revision to keep up with scammer innovations. Recently, at the direction of Congress, the Federal Trade Commission began investigating the need to ban suspicious practices as unfair and deceptive.

The following subsections review these developments and existing laws, and analyze the features of an effective approach to loan modification scams. This analysis pays particular attention to the question of exemptions from any law or regulation, as this issue is likely to be fiercely contested, with various groups seeking blanket exemptions.

A. What States Can Do

1. Existing State Foreclosure Consultant Laws

So far, almost all the activity to rein in loan modification scams and other forms of foreclosure rescue scams has been on the state level. Federal law does not preempt state regulation of foreclosure rescue scams, so states that choose to pass laws governing these activities face no significant obstacles. States are also in a position to address the interplay with state licensing regimes for attorneys, mortgage brokers, and others who may seek exemptions but can also be part of the problem.

In the past five years, a number of states have enacted foreclosure rescue scam laws that, while probably not enacted with loan modification scams in mind, clearly encompass

these new companies. At least 24 states and the District of Columbia now have laws that impose constraints on foreclosure rescue operations, both those that merely involve a fee for service, and the sale/leaseback scams that involve transfer of title.⁵¹ Though not every state law contains every provision, the typical foreclosure consultant laws:

- Ban up front payments;
- Ban any compensation until the consultant has fully performed every promised service;
- Require the contract to detail exactly what the consultant is promising to do;
- Require the consultant to give the homeowner notice of the right to cancel the contract within 3 to 5 days – which is extended if the notice is not given or the contract otherwise violates the statute;
- Require other disclosures;
- Prohibit the consultant from obtaining a power of attorney;
- Prohibit the consultant from receiving compensation from a third party;
- Prohibit an array of deceptive, unfair, and abusive practices.

Some laws also prohibit the consultant from taking an interest in the property and require the contract to be written in the same language used to negotiate with the homeowner. State laws normally exempt non-profits and a variety of licensed entities. The issues posed by these exemptions are discussed below.

These laws have given enforcement agencies and homeowners useful tools. A number of states have used their foreclosure rescue laws against loan modification firms. More than

⁵¹ Arizona, California, Colorado, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Maryland, Minnesota, Missouri, Nebraska, Nevada, New Hampshire, New York, Oregon, Rhode Island, Washington and Wisconsin have specific foreclosure rescue laws. Massachusetts has enacted similar, but less detailed, provision in regulations under the state's unfair and deceptive acts and practices statute. Other states, like Michigan, have credit repair statutes imposing similar provisions that may be broad enough to apply to foreclosure rescue operations.

20 state law enforcers have taken actions against companies engaged in these types of deception, including 22 cases brought by Illinois Attorney General Madigan.⁵²

A few states have taken a fresh look at their laws in light of the appearance of loan modification scams. Illinois recently lowered its cap on the total fees for foreclosure consultant or loan modification services to 50% of the homeowner's monthly mortgage payment, unless the homeowner's mortgage payments are reduced for at least five years, in which case the cap goes up to the lesser of the value of any loan reduction for 12 months or one full monthly mortgage payment.⁵³ Tying a fee cap to results is a useful way to enforce a rule that consultants may only earn a fee if they obtain an affordable loan modification⁵⁴ for the borrower.

California permits real estate department licensees who wish to charge advance fees for loan modification services to submit their contracts for approval, and approved companies are listed on the department's website. However, licensing or approval requirements that do not have real teeth in them—requiring clear results for any fee—can have the effect of giving the state's imprimatur to potential scammers without effective oversight.⁵⁵ Merely licensing loan modification companies is unlikely to be an effective approach.

2. Weaknesses of Existing State Laws

While the existing state laws are helpful in many ways, they were generally not adopted with loan modification scams in mind and, consequently, have a number of weaknesses when applied to loan modification scams.

The first problem is limitations in the scope of these laws. Most state laws only address services to homeowners who are in foreclosure or are 30 to 90 days in default. NCLC

⁵² See Press Release, Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams, Federal Trade Commission (Apr. 6, 2009), <http://www.ftc.gov/opa/2009/04/hud.shtm>.

⁵³ 765 Ill. Comp. Stat. § 940/70 (effective Apr. 6, 2009).

⁵⁴ There is no universally recognized definition of an affordable, sustainable loan modification. This report uses the term to describe a modification that calls for regular monthly payments which enable the homeowner to keep the home and which the homeowner can afford to pay each month, indefinitely, without falling behind on other reasonable debts and household expenses (barring unforeseen events).

⁵⁵ At least one company advertises “DRE [Division of Real Estate] Approved Loan Modification Services.” <http://www.serviceloanmodification.com/loan-modification-dre.html>.

recommends expanding the scope of these laws to include all homeowners, regardless of whether they are in default. The mortgage servicing industry and others have urged homeowners to seek help before they go into default. Expanding the scope of these state laws would align the law with the widely disseminated message to seek help early. There is also no legitimate public policy reason to protect one group of homeowners from these scams but not another. As described in detail in Section V(D) below, another scope problem is that many state laws create blanket exemptions for certain categories of actors.

A second common weakness is that the prohibition of advance fees in many of the existing laws is easy for loan modification scammers to evade. Companies should not be permitted to avoid an advance fee ban by taking the money “in trust” until the “services” are performed. Of course, if the only service performed is to make calls without achieving a loan modification, the homeowner has no protection.

NCLC recommends that states adopt a foreclosure rescue law that addresses loan modifications and scams involving title transfers. NCLC has already issued a model law addressing title transfers, a copy of which is included in Appendix B to this report. An effective loan modification law should, at a minimum:

- Apply to all homeowners, regardless of whether they are in default on their mortgages;
- Ban fees until the homeowner actually receives an affordable, sustainable loan modification;
- Require the contract to detail exactly what the foreclosure consultant is promising to do and to provide a deadline;
- Give homeowners the right to cancel a foreclosure consultant contract for any reason within 3 to 5 days—with an automatic extension if the consultant fails to provide written notice of the right to cancel or the contract otherwise violates the statute;
- Prohibit the consultant from obtaining a power of attorney from the homeowner;
- Prohibit the consultant from receiving compensation from a third party;
- Include effective penalties *in addition to* forfeiture of any fees for violations;

- Be enforceable by the injured homeowner.

An effective law should also require scammers to reimburse the victimized homeowner for legal fees incurred while trying to enforce the law. Otherwise, distressed homeowners who cannot afford their own mortgage and who may have been swindled out of thousands of dollars by a loan modification scammer will not be able to afford to enforce the law.

B. What the Federal Government Can Do

1. General Principles

There is also a potential role for federal legislation in addressing loan modification scams. Federal legislation could be very helpful in reining in loan modification scams if it:

- Creates strong, significant protections and not just disclosure hoops for scammers to jump through;
- Is enforceable by the homeowners who are victimized and creates significant penalties for the scammers;
- Is a floor and not a ceiling and does not preempt stronger state laws;
- Helps in developing a clear national message about the dangers of these schemes;
- Does not excessively restrict legitimate services outside the scope of the statute; and
- Does not end up inadvertently legitimizing a very problematic industry.

While federal legislation regarding “phantom help” foreclosure rescue and loan modification scams would help consumers if it met these standards, NCLC does not recommend new federal legislation to address sale/leaseback scams in which the homeowner’s title is actually transferred. These scams, which target home equity, are less prevalent in today’s declining market. The federal Truth In Lending Act has been effectively used in combination with state equitable mortgage doctrines to invoke TILA’s rescission remedies. Specific state legislation has also been effective in giving homeowners remedies. Anything short of a complete, strong, flat out federal ban on sale/leaseback transactions could risk undermining these successful strategies and legitimizing a model that provides no benefits to homeowners.

2. What the Federal Trade Commission Can Do

The Federal Trade Commission may be poised to issue new regulations to crack-down on loan modification and foreclosure rescue scams. The 2009 Omnibus Appropriations Act directed the FTC to initiate a rulemaking proceeding regarding mortgage loans. In June 2009, the FTC started the process by issuing an Advance Notice of Proposed Rulemaking on Mortgage Assistance Relief Services.⁵⁶ The “MARS rulemaking,” as it has been nicknamed, seeks public input on “unfair and deceptive acts and practices that should be prohibited or restricted.”⁵⁷

The ANPR has a broad scope “address[ing] the practices of entities (other than mortgage servicers) who offer assistance to consumers in dealing with owners or servicers of their loans to modify them or avoid foreclosure.”⁵⁸ Presumably this includes attorneys, mortgage brokers, real estate brokers, and nearly anyone else offering to help homeowners modify their mortgages. The FTC’s jurisdiction does not include banks, thrifts, credit unions, or non-profit organizations, but the ANPR notes that the FTC does have jurisdiction over for-profit entities that contract with non-profits or financial institutions to provide loan modification or foreclosure rescue services.⁵⁹

While issuing an ANPR does not guarantee the FTC will ultimately issue any rules, this process offers the potential for the FTC to dramatically improve homeowner protections, as long as it does not preempt stronger state laws or regulations. The FTC and states will have the authority to enforce the rules by seeking civil penalties or other relief against anyone covered by the rules.⁶⁰ In some states private individuals may also be able to enforce the rules using state law prohibiting unfair and deceptive acts and practices. The FTC could ease private enforcement of rules by requiring covered businesses to include specific consumer protection clauses in their contracts, as the FTC did with the Holder Rule, 16 C.F.R. § 433.2.

⁵⁶ 74 Fed. Reg. 26130, 26131 (June 1, 2009). The FTC also issued a separate ANPR regarding Mortgage Acts and Practices which will address more generally activities that occur throughout the life-cycle of a mortgage loan. Advance Notice of Proposed Rulemaking: Mortgage Acts and Practices, 74 Fed. Reg. 26118 (June 1, 2009).

⁵⁷ 74 Fed. Reg. at 26131.

⁵⁸ *Id.*

⁵⁹ *Id.* at 26132.

Most importantly, the FTC should promulgate regulations that:

- ***Prohibit Up-Front Payments for Mortgage Assistance Relief Services.*** NCLC encourages the FTC to ban mortgage assistance relief services from seeking up-front payments. Prohibiting up-front payments will curb the injury and unfairness caused when companies take large payments from borrowers and fail to obtain loan modifications on their behalf, whether the outfit is an outright scam or merely ineffective. Once a mortgage assistance company obtains the borrower's money, it can be extremely difficult to obtain a refund or other relief if the company fails to do as promised. Requiring these companies to obtain the promised loan modification as a condition of being paid will substantially reduce their incentive for making false promises of foreclosure assistance.
- ***Require Affordable, Sustainable Loan Modifications.*** Fees should be permitted for loan modification firms only if their services produce sustainable, affordable loan modifications. Unlike non-profit HUD-certified housing counselors, a for-profit loan modification company is likely to push the homeowner to accept the first modification offered even if the terms of the modification are unaffordable. Research has proven that the loan modifications many servicers offer do little to make loans more affordable, and that poorly designed modifications often end in re-default, harming both the borrower and mortgage holder.⁶¹ Charging a borrower for arranging an unaffordable modification is unfair because the modification is worthless. It wastes the borrower's limited funds and costs valuable time as the foreclosure deadline approaches. For-profit entities should only be allowed to charge for their services if they succeed in helping the borrower obtain an affordable, sustainable loan modification.

⁶⁰ *Id.*

⁶¹ Even though the OCC has found re-default rates to be highest for modifications that increase the monthly payment or leaves the payment unchanged, servicers reported making this type of modification 54.6% of the time between January 2008 and March 2009. OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 1st Quarter 2009, 24 and 31 (6/30/09), <http://www.occ.gov/ftp/release/2009-77a.pdf>. See also White, Alan M., *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications* (Jan. 9, 2009) Connecticut Law Rev. (forthcoming), <http://ssrn.com/abstract=1325534>.

- ***Tie Compensation to Results Achieved.*** Fees for loan modification services should be commensurate with the benefit to the homeowner. Loan modification and foreclosure rescue scammers make big promises and charge thousands of dollars but often deliver little. Homeowners go to them for one reason—to save their homes from foreclosure. Any fee charged should bear a reasonable relationship to the benefit actually provided to the homeowner.

Illinois' Mortgage Rescue Fraud Act⁶² is a good model for limiting compensation to a reasonable amount: For modifications that reduce the monthly payments on a loan for at least 5 years, the fee is capped at the lesser of the existing principal and interest payment or the total net savings from the lowered payments over the succeeding 12 months. For all other transactions, the maximum fee cannot exceed 50% of the homeowner's existing monthly payment.⁶³

- ***Avoid Exemptions That Open Wide Loopholes, While Avoiding Excessive Restrictions On Legitimate Services.*** An exemption to the proposed restriction on up-front fees is not necessary for mortgage and real estate brokers when they are acting in those roles, as they would not normally collect any fee in any event until a property is sold or a loan is closed. If brokers are involved in mortgage assistance relief services beyond these roles, they should be subject to the ban on up-front fees. An exemption is necessary for attorneys in order to protect legitimate legal advice, but the exemption should be drawn narrowly to require full compliance with ethical rules and to avoid evasions for work by non-lawyers.
- ***Provide a Floor to Protect All Homeowners, But Not a Ceiling.*** A number of states have already implemented strong, effective laws and regulations regarding this industry and other states may do so in the future. The FTC should issue new rules to protect homeowners in states that have not enacted any protections. But, the FTC should make clear that federal regulations do not preempt stronger state laws or rules. It is essential that states have the flexibility to respond quickly and creatively to new forms of loan modification scams.

⁶² 765 ILCS 940/1 *et seq.*

⁶³ 765 ILCS 940/70.

- ***Address Ineffective mortgage servicing.*** If servicers did their work properly, far fewer homeowners would need to consider the for-profit foreclosure rescue industry. Mortgage servicers should be required to give borrowers contact information for specifically identified servicer representatives who have the information and authority necessary to answer questions and fully resolve loss mitigation issues—including the power to modify loans, agree to short sales, and accept deeds-in-lieu of foreclosure.

The FTC has already warned 71 companies that they may be deceptively marketing modification or foreclosure rescue services and has sued numerous others. By issuing strong rules that do not preempt stronger state protections, the FTC could dramatically improve homeowner protections in states lacking effective regulation of this freewheeling industry. The deadline for submitting comments is July 15, 2009. Comments are best submitted online at:

<https://secure.commentworks.com/ftc-mortgageassistancereliefservices/>

C. The Tricky Issue of Exemptions: To What Extent Should Attorneys, Real Estate Brokers and Other Licensed Entities Be Exempt?

Whether it is a state legislature, Congress, or the FTC that is considering measures to rein in loan modification scams, a central question is the entities to which the restrictions should apply. Companies and individuals – such as real estate brokers, attorneys, mortgage brokers, mortgage lenders, and depository institutions – are likely to argue that others should be regulated, but that they should not.

A blanket exemption for any of these categories of actors is dangerous. Entities and individuals such as these have been involved in credit repair scams, foreclosure rescue scams, and property-flipping scams, either openly or as fronts for unlicensed actors.⁶⁴

⁶⁴ See, e.g., Fed. Trade Comm'n v. Gilkl, 265 F.3d 944 (9th Cir. 2001) (attorney allowed credit repair operator to work out of his office); Vaughn v. Consumer Home Mortg., Inc., 2003 WL 21241669 (E.D.N.Y. Mar. 23, 2003) (denying motion to dismiss by attorneys involved in property flipping scheme); Hoffman v. Stamper, 867 A.2d 276 (Md. 2005) (loan officer and appraiser were involved in property flipping scam); Press Release, *Brown Sues Foreclosure Consultant and Attorney Who Conned Homeowners into Paying Thousands for Phony Lawsuits*, Cal. Attorney General (July 6, 2009), <http://ag.ca.gov/newsalerts/release.php?id=1763>.

If any exemptions are provided, three important principles should be followed. First, any exemption should extend only to conduct within the scope of the individual's license. So, for example, if the FTC or a legislature decided to exempt attorneys, it should limit the exemption to conduct within the scope of an attorney's license, *i.e.* practicing law. Such an exemption should not extend to other activities.

Second, it rarely makes sense for an exemption to be a complete exemption from all the requirements of the statute. Even if the FTC or a legislature ultimately decides, for example, that some group should be exempt from an advance fee prohibition, exempting it from a prohibition on taking an interest in the consumer's home may not be appropriate.

Third, any cross-reference to another statutory licensing scheme should be examined carefully. In particular, some mortgage and real estate broker licensing laws are written broadly and may cover those who offer "services" beyond their traditional roles of finding mortgages or selling homes. These broadly applicable laws can be helpful in cracking down on loan modification scams. For example, Pennsylvania was able to use its mortgage broker licensing requirements to crack down on out-of-state loan modification companies.⁶⁵ On the other hand, if an exemption in a loan modification scam or foreclosure rescue law incorporates a state mortgage or real estate broker licensing law by reference, the legislature may find that it has exempted a much larger group than it intended.

But the more fundamental question is whether these individuals and entities should have any exemption at all. The notion that a mortgage broker's license – or an attorney's license, real estate agent's license, or any other license – ensures that the licensee will not cheat people is palpably false. On the other hand, many holders of these types of licenses do have skills that could help homeowners in trouble.

Massachusetts' foreclosure consultant regulation provides a useful model. It is the strictest of the foreclosure rescue laws in terms of coverage.⁶⁶ The only exemptions to the advance fee ban are for attorneys who prepare or file a bankruptcy petition or court

⁶⁵ See Press Release, *Banking Department Takes Action Against Mortgage Modification Companies*, Penn. Dept. of Banking (Apr. 23, 2009). Though Pennsylvania does not presently have a specific foreclosure rescue statute, if it decides to adopt one it needs to be careful about the interplay with this broad interpretation of the mortgage broker statute.

⁶⁶ See 940 Code Mass. Reg. 25.02(b).

proceedings to avoid a foreclosure, or loan application fees paid to a licensed mortgage broker or licensed mortgage lender. The regulation also requires that the attorney, broker or lender comply with all applicable laws and regulations. Maryland's law achieves a similar result by exempting mortgage and real estate brokers only when refinancing a mortgage or engaged in selling the property, respectively.⁶⁷

Creating a narrow exemption along the lines of the Massachusetts regulation that only allows loan application fees to be charged in advance, and only by licensed mortgage brokers or lenders, avoids the problem of an overbroad exemption. Prohibiting advance fees will not have a significant effect on real estate or mortgage brokers when they work in the traditional scope of their businesses because these brokers are normally paid only when a sale or mortgage transaction is completed. But, if real estate or mortgage brokers try to capitalize on the foreclosure crisis by expanding beyond their traditional businesses (of finding mortgages or selling homes) into loan modification or foreclosure rescue efforts, they should be covered by the same rules as other foreclosure consultants.

The role of attorneys is more complicated. Attorneys can play a wide number of roles in helping a client avoid foreclosure, including filing a bankruptcy petition, filing a suit challenging a predatory loan or a defense to foreclosure, and other activities that do not involve litigation, such as advising a client of potential claims or defenses, giving advice about the intricacies of loan modification programs, or negotiating a settlement with a lender outside of litigation. Though some attorneys have unquestionably been involved in harmful conduct, an attorney's more beneficial and traditional role of analyzing a client's paperwork and advising the client of potential claims and options also fits within the definition of foreclosure consulting services. These services take time, cannot always be offered for free, and cannot guarantee success. Thus, drawing a clear line that excludes harmful conduct but does not prevent beneficial advice and activities is not so easy.

Attorneys are also regulated at the state level, and misconduct can lead to revocation of their licenses, a severe sanction that does have a deterrent effect. In many states, attorneys also are required to carry malpractice insurance and may be more reachable than other scammers when things go wrong. On the other hand, a broad exemption for attorneys

⁶⁷ See Md. Real Prop. § 7-302.

could encourage scammers to use the guise of an attorney license to cloak activities by nonlawyers and avoid such protections as advance fee bans.

Lawmakers should consider ways to narrow any exemption for attorneys to exclude these types of activities:

- Attorney exemptions should be limited to work that qualifies as the practice of law and to attorneys in compliance with Rule 5.4 of the American Bar Association's Model Rules of Professional Conduct. Rule 5.4 prohibits attorneys from sharing legal fees or practicing law in a law firm or other business where a nonlawyer controls the attorney's professional judgment.⁶⁸
- Attorneys should only be entitled to the exception for work in the state where they are licensed, within the scope of that license, and in compliance with local ethical requirements.

⁶⁸ Rule 5.4 Professional Independence of a Lawyer:

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and

(4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation ; or

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

- Attorneys should be permitted to charge advance fees only where the fee or retainer is placed in a client trust account until the work requested is performed as agreed, even where state bar rules do not already impose such a requirement.
- Homeowners should be permitted to cancel the retainer agreement at any time and receive a refund of any unearned fees.
- State bars should also do a better job of cracking down on abusive advertising practices by attorneys. This may include prohibiting attorneys from advertising services that hold out the promise of a loan modification.

The only blanket exemption that policymakers should consider is one for non-profit. To date there has not been any indication that such an exemption would be problematic. But, it is important to remain vigilant for the creation of sham non-profits, as has occurred in the credit repair context to avoid the Credit Repair Organizations Act, 15 U.S.C. §§ 1679-1679j. To guard against sham non-profits, any exemption for non-profit organizations should require that the organization not only have IRS § 501(c)(3) status but that it also be operating as a bona fide non-profit organization.

D. Outreach & Enforcement

In addition to legislation and regulations, it is important to launch a robust national campaign against foreclosure and foreclosure rescue scams. Federal and state governments, lenders, servicers, housing counselors, and community-based organizations must come together to launch a national campaign that would combine social awareness, emergency assistance, and strong enforcement against fraudulent rescue scams. Public Service Announcements in various media and languages can build awareness of what homeowners should do in the case of mortgage delinquency and where to turn for help. The campaign should also direct families to HUD-approved counseling agencies in their neighborhoods for further assistance. Antiquated foreclosure laws should be updated to address modern realities.⁶⁹

⁶⁹ See National Consumer Law Center, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic Protections* (Feb. 2009), www.nclc.org.

To complement the public education component, a national campaign must include strong enforcement action by the FTC and state government against predatory foreclosure rescue operations. These scams take advantage of underserved communities at their most vulnerable point. Without strong enforcement action against these predators, education and referral efforts will not be successful. The FTC and authorities in some states have already taken action against a number of abusive loan modification and foreclosure rescue entities.⁷⁰ Issuing effective rules would make it easier for the FTC to prosecute scams in the future and would provide a clear deterrent by clarifying prohibited conduct. Effective rules would also enable states lacking their own provisions to enforce the regulations in state or federal court.

Foreclosure rescue scammers are following the same pattern as predatory lenders by targeting vulnerable homeowners including minorities, non-English speakers, seniors, and low-income neighborhoods. Those without an adequate education or English proficiency are often primary targets for deception and fraud because they do not hear warnings about avoiding scams and are ill-informed about the legitimate, free resources available to them. To reach these homeowners it is critical to make strategic investments in the community-based organizations serving them. States and the federal government should provide funding for minority-serving organizations to develop marketing strategies for minority communities. In addition, multi-lingual outreach material should be accessible to local groups as well as funding to distribute outreach material to appropriate media outlets.

VI. CONCLUSION

Poor mortgage servicing has pushed many borrowers to seek assistance from loan modification companies, but the loan modification industry is complicit in fleecing financially distressed homeowners. Many times these companies require up-front fees based on promises of loan modifications that never materialize. While many states have taken steps to curb these practices, existing laws should be tightened up.

Congress can help first and foremost by addressing the servicing problem and by providing more resources for HUD-approved housing counseling agencies and enforcement.

⁷⁰ See 74 Fed. Reg. 26130, 26135 n. 44 (June 1, 2009) (listing lawsuits the FTC has filed with

Congress could also adopt strong, minimum, national standards to assist the many states that do not have foreclosure rescue laws.

The Federal Trade Commission's recent advance notice of proposed rulemaking offers the best chance for protecting desperate homeowners from opportunistic scammers and incompetent loan modification and foreclosure rescue services. It is important for consumer advocates, housing counselors, and members of the public to respond to the FTC's request for comments so the FTC is fully equipped to issue appropriate regulations. The FTC should issue regulations that provide a floor to protect homeowners in states with inadequate protections and which ban advance fees; prohibit compensation until the homeowner gets an affordable, sustainable loan modification; require compensation to bear a reasonable and proportional relationship to the benefit provided to the homeowner; and which avoids overly broad exemptions. Issuing strong, effective regulations will protect distressed homeowners when they most need it.

allegations of deceptive practices in loan modification services).

Appendix A

LIST OF STATE LAWS REGARDING FORECLOSURE RESCUE & LOAN MODIFICATION

A number of states have special laws aimed specifically at foreclosure rescue scams:

California: Cal. Civ. Code §§ 1695.1 to 1695.17, 2945.1 to 2945.11;

Colorado: Colo. Rev. Stat. §§ 6-1-1101 to 6-1-1120;

Connecticut: Public Act 9-208 §§ 23 to 33; (Passed by the legislature but not yet signed by the Governor, as of July 7, 2009.)

District of Columbia: D.C. Code §§ 42-2431 to 42-2435;

Georgia: Ga. Code Ann. § 10-2-393(b)(20);

Hawaii: Haw. Rev. Stat. §§ 480E-1 to 480E-5;

Idaho: Idaho Code §§ 45-1505, 45-1602;

Iowa: Iowa Code §§ 714E.1 to 714E.4, 714F.1 to 714F.9;

Illinois: 765 Ill. Comp. Stat. §§ 940/1 to 940/65;

Indiana: Ind. Stat. 24-5.5-1-1 to 24-5.5-6-6;

Maryland: Md. Real Prop. Code Ann. §§ 7-105(A-1), 7-301 to 7-321;

Minnesota: Minn. Stat. Ann. §§ 325N.01 to 325N.18;

Missouri: Mo. Stat. Ann. §§ 407.935 to 407.943;

Nebraska: Neb. Rev. Stat. §§ 76-2701 to 76-2728;

Nevada: Nev. Rev. Stat. §§ 645F.300 to 645F.450;

New Hampshire: N.H. Rev. Stat. §§ 479-B:1 to 479-B:11;

New York: New York Real Prop. Law § 265-a;

North Carolina: N.C. Gen. Stat. § 14-423 (adding foreclosure assistance to activities covered by state debt adjustment law);

Oregon: 2008 Oregon Laws 1st Sp. Sess. Ch. 19 (H.B. 3630);

Rhode Island: R.I. Gen. Laws §§ 5-78-1 to 5-79-9;

Tennessee: Tenn. Code Ann. §§ 47-18-5401 to 47-19-5402;

Virginia: Va. Code § 59.1-200.1;

Washington: Wash. Rev. Code §§ 61.34.010 to 61.34.900;

Wisconsin: Wis Stat. §§ 846.40 to 846.45.

In addition, the Massachusetts Attorney General has issued a regulation under the state's UDAP authority targeting the scams: 940 Code Mass. Reg. § 25.00.

Michigan has a credit repair statute that is broad enough to encompass foreclosure rescue scams: Mich. Comp. Laws §§ 445.1822 to 445.1825.

Florida has a statute that regulates only those who offer to purchase the surplus at a foreclosure sale: Fla. Stat. §§ 45.031 to 45.035.

Appendix B

MODEL STATE FORECLOSURE RESCUE FRAUD PREVENTION ACT & INTRODUCTORY MEMORANDUM TO STATE LEGISLATORS

To: State Legislators Interested in Combating Foreclosure Rescue Scams
From: National Consumer Law Center¹
Date: March 11, 2008
Re: NCLC Model Foreclosure Rescue Statute

The foreclosure crisis has presented the perfect opportunity for foreclosure rescue scams. These scams come in two main varieties.² In the first, a foreclosure “consultant” takes an up front payment and promises to arrange refinancing or postpone the foreclosure, but does nothing and costs the homeowner not only money but critical time. In the second, the rescuer takes title to the property “temporarily” with the promise that the homeowner will get it back, a promise that always fails. These sale/leaseback scams are designed to steal the home’s equity.

NCLC has drafted a model state law designed to combat the more complicated sale/leaseback scams. Our model law builds upon but differs from the two approaches that some states have enacted. Several states have regulated foreclosure rescue scams by specifying requirements for the contracts and giving the homeowner a right to cancel. More recently, the Massachusetts Attorney General issued an order under her unfair and deceptive acts and practices authority completely banning foreclosure rescue transactions, and the District of Columbia enacted a similar prohibition by statute. These different approaches have had some success, though they have not completely stopped foreclosure rescue scams.

Our model law builds upon the centuries-old common law equitable mortgage doctrine to call a sale/leaseback transaction what it is: a loan. The model law requires the rescuer to comply with lending laws, deems the rescuer’s deed to be merely a mortgage, and deems the rescuer to be merely a lender, with no right to evict or encumber the property.

The model law has the following advantages over the other approaches:

¹This memorandum was written by Lauren Saunders, Managing Attorney of NCLC’s Washington, DC office.

²For more background, see NCLC, “Dreams Foreclosed: The Rampant Theft of America’s Homes Through Equity-Stripping “Foreclosure Rescue” Scams (2005), www.nclc.org/news/content/ForeclosureReportFinal.pdf.

- It is simple to apply.
- It does not send out a mixed message that it is acceptable to take a homeowner's title as long as contract requirements are satisfied.
- It may be more appealing to legislatures that are concerned about banning all foreclosure rescue transactions outright.
- It includes a clear, detailed remedy scheme that none of the existing statutes has, showing precisely how to restructure a transaction that looks like a sale into a loan.
- It provides a workable approach to helping homeowners who received some cash from the rescuer that they cannot afford to pay back immediately.
- It clarifies the warning signs that third party lenders, buyers, title insurers and escrow companies should look for to ensure that they do not unwittingly enable these scams.

Our model law makes clear and explicit what the other statutes leave implicit. Under all the existing statutes, once the transaction is found to be unlawful, it is generally necessary to resort to the common law equitable mortgage doctrine or the federal Truth in Lending Act to unwind the transaction. Yet courts are sometimes uncomfortable doing so without clear direction or more recent case law than equitable mortgage cases that could be a century old.

In addition, the model law attempts to achieve a more complete remedy and, better yet, to stop the scams from happening by depriving scammers of the unwitting assistance of third parties that are critical to the deals. No matter what approach is taken, scammers will violate the law because they are lawbreakers. But even once the scammer is caught, complete relief is often impossible because the home has been encumbered by a new loan from a bona fide lender, or title has been passed to a bona fide purchaser. The model law specifies the warning signs that should put a third party on notice to inquire into the homeowner's status before getting caught in the middle. Scammers will be unable to complete their transactions if legitimate title or escrow companies will not close their deals, if legitimate lenders will not finance them or enable them to get their money out, and if the scammers cannot flip the properties to legitimate buyers.

Note that the model law's remedy and bona fide purchaser provisions are also adaptable to supplement the existing "regulate it" and "ban it" approaches.

For more information, contact Lauren Saunders in NCLC's Washington office.

About NCLC

National Consumer Law Center is a non-profit organization with nearly 40 years of working experience in consumer issues, especially those affecting low-income consumers. NCLC works with and offers training to thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income and elderly people. Note that NCLC does not directly assist individuals.

NCLC has extensive experience in mortgage lending and the problem of foreclosure rescue scams and has published several reports and legal treatises on the issue. More detailed advice on the legal theories used to assist homeowners in foreclosure or to attack foreclosure

rescue transactions can be found in the Foreclosure Rescue Scams chapter of *Foreclosures: Defenses, Workouts, and Mortgage Servicing* (2d ed. 2007 & Supp.). Other legal treatises include *Truth in Lending* (6th Ed. 2007 & Supp.) and *Unfair and Deceptive Acts and Practices* (7th ed. Forthcoming 2008). Other publications that can be useful to lay advocates include *Foreclosure Prevention Counseling* (1st ed. 2007); *Stop Predatory Lending* (2d ed. 2007); and *Surviving Debt* (7th ed. 2008). Ordering information can be found on our website.

MODEL STATE FORECLOSURE RESCUE FRAUD PREVENTION ACT

January 18, 2008

1. Title; Declaration of Purpose

- 1.1. This Chapter shall be known as the "Foreclosure Rescue Fraud Prevention Act."
- 1.2. This Act shall be liberally construed to effectuate its purpose, which is to prevent homeowners who are facing foreclosure from becoming the victim of persons who purport to help save the home while actually taking title to the home and the homeowner's equity.
- 1.3. The legislature finds that when a homeowner transfers title to the home as part of a foreclosure rescue transaction, the homeowner's intent is merely to provide security for the loan of money to avoid foreclosure, not to transfer the home to the rescuer. The purpose of this law is to require that all foreclosure rescue transactions comply with lending laws; to provide a mechanism to restructure foreclosure rescue transactions and other equitable mortgages from a transfer of title into a loan to conform with the homeowner's intentions; to define and forbid certain unfair foreclosure rescue transactions; to set out factors that put a potential purchaser or lender on notice to inquire as to the rights of a person in possession of the property; and to set out remedies for a violation of the Act.

2. Definitions

- 2.1. "Bona fide purchaser or lender."
 - 2.1.1. "Bona fide purchaser or lender" means anyone acting in good faith who purchases property, as defined in this Act, from the grantee for valuable consideration or makes a mortgage loan to the grantee or a subsequent bona fide purchaser, provided that he or she had no prior notice of the homeowner's continuing interest, equity or right to possess the property, of the facts deeming the deed or conveyance to be an equitable mortgage, or of any violation of this Chapter.
 - 2.1.2. In addition to any other grounds for notice under state or federal law, a purported bona fide purchaser or lender is on inquiry notice as to the rights of any person in possession of the property if the purchaser or lender, or his or

her agent, has notice (i) that the property is or was in foreclosure or default, or was within the previous 12 months, and (ii) one or more of the following factors applies:

- 2.1.2.1. the total consideration paid to the homeowner, as described in section 5.6.1, was less than 82% of the fair market value of the property;
- 2.1.2.2. the homeowner intends to remain or has remained in the property after transferring title;
- 2.1.2.3. the grantee who seeks to sell or mortgage the property does not intend to live or is not living in the property after acquiring title;
- 2.1.2.4. the property was transferred from the homeowner through a quit claim deed³ or power of attorney, or without a formal closing;
- 2.1.2.5. the grantee seeks a purchase money loan and the purported bona fide lender failed to review the purchase and sale documents governing the grantee's acquisition of the property;
- 2.1.2.6. encumbrances remain or will remain on the property for which the homeowner could be liable after transfer of title;
- 2.1.2.7. any payments made upon the transfer of title from the homeowner (i) are characterized as payoffs of liens or other encumbrances not on the title, (ii) are due to the homeowner but are assigned to another person; or (iii) violate the Real Estate Settlements Procedures Act, 12 U.S.C. § 2601 *et seq.* ;
- 2.1.2.8. the grantee is an inter vivos trust created after the default or foreclosure;
or

³ The reference to a quit claim deed is intended for states where use of such a deed would be unusual in a traditional sale of a residential property. States where quit claim deeds are the norm should consider whether this language should be amended, and states should consider adding other unusual types of deeds or other aspects of the transfer that would be unusual and would be a red flag.

2.1.2.9. the purchaser or lender has any other reason to know that the deed or conveyance is an equitable mortgage or that the homeowner intends to retain title to or possession of the property.

2.2. “Foreclosure” means the state law process by which a person with a security interest in residential property may foreclose on that security interest.

2.3. “Foreclosure rescue transaction.”

2.3.1. “Foreclosure rescue transaction” means a transaction that meets all of the following elements:

2.3.1.1. property subject to this Act is conveyed by a homeowner to a grantee;

2.3.1.2. the property is, or was at the time of the foreclosure rescue transaction, in default or foreclosure;

2.3.1.3. the transaction is designed, intended or promoted by the parties as a means to avoid or delay actual or anticipated foreclosure proceedings against the property while permitting the homeowner to maintain a legal or equitable interest in the property conveyed, including, without limitation, a lease interest, a right to possession, an option to acquire the property, or other interest in the property conveyed; and

2.3.1.4. the grantee enters into the transaction for compensation or gain or for potential or contingent compensation or gain.

2.3.2. A transaction shall not be deemed to be a foreclosure rescue transaction merely because it provides the homeowner up to three months beyond the transfer date to vacate the property, provided that it is clear from all of the circumstances that the homeowner has no expectation of remaining in the property beyond the date to vacate.

2.3.3. The term “foreclosure rescue transaction” includes any contract, agreement, or arrangement, or any term thereof, between a grantee and a homeowner that is incident to a foreclosure rescue transaction.

2.3.4. Parol evidence is admissible to show that a transaction is a foreclosure rescue transaction.

- 2.4. "Formal closing"⁴ means an in-person, face-to-face meeting with the homeowner conducted by and in the office of a closing agent who is not employed by or affiliated with the grantee to complete final documents incident to the sale or transfer of an interest in property, or the creation of a mortgage or equitable interest in property, during which the homeowner must be presented with a completed copy of any settlement statement required under state or federal law.
- 2.5. "Grantee" means any person who acquires title to property, as defined in this Act .⁵ The term "grantee" includes the grantee's representative as defined in this subdivision, successor in interest, or any person acting in joint venture or joint enterprise with the grantee. The term "grantee" does not include a person who acquires title as follows:
- 2.5.1. by a deed as a result of a foreclosure sale;
 - 2.5.2. by a deed in lieu of foreclosure of any voluntary lien or encumbrance of record, other than a lien or encumbrance created in connection with a foreclosure rescue transaction;
 - 2.5.3. at a short sale at which the outstanding obligations against the property, other than obligations created in connection with a foreclosure rescue transaction or equitable mortgage, are greater than the fair market value of the property;
 - 2.5.4. at any sale of property authorized by statute;
 - 2.5.5. by order or judgment of any court; or
 - 2.5.6. as a bona fide purchaser or lender as defined in this Act.
- 2.6. "Homeowner" means a natural person who, at the time of the foreclosure rescue transaction or the creation of an equitable mortgage, held title to the property as defined in this Act.

⁴ States should substitute "settlement" or other appropriate local terminology.

⁵ States where property is normally held through long term leases should include long term leaseholders in this definition.

- 2.7. “In default” means a property whose owner is more than 90 days delinquent on any loan or debt, including real estate taxes, that is secured by the property.
- 2.8. “In foreclosure” means a property for which a secured party or taxing authority has initiated a foreclosure.
- 2.9. “Property” means residential property, whether real or personal, including condominiums, modular homes or manufactured or mobile homes, consisting of from one to six dwelling units at least one of which is occupied or was occupied prior to the transfer of title to the property by the homeowner as a primary residence.
- 2.10. “Representative” means a person who in any manner solicits, induces, arranges, or causes a homeowner to transfer title or solicits any member of the homeowner’s family or household to induce or cause a homeowner to transfer title to the property pursuant to a foreclosure rescue transaction.
- 2.11. “Title”⁶ includes title to or ownership of the property, as well as ownership of an interest in the property through a trust document.

3. **Equitable Mortgages.**⁷

- 3.1. Every deed or other conveyance of an interest in property that purports to be an absolute conveyance of title to property but was made as security for the performance of an obligation, is deemed to be an equitable mortgage. The obligation may have been created prior to or contemporaneous with the conveyance and need not be the personal liability of any person.
- 3.2. Intent that the deed or other conveyance serve as security may be inferred by a preponderance of the evidence from the totality of the circumstances, including but not limited to the following factors:
- 3.2.1. statements of the parties;

⁶ States where property is normally held through long term leases should include possession of such a lease in the definition of “title.”

⁷ Sections 1.1 to 1.3 are adapted from the Restatement (3d) of Property-Mortgages. § 3.2 and 3.3. Many states have versions of or limitations on the equitable mortgage doctrine, though generally not this detailed. Existing provisions should be reviewed for consistency and, if appropriate, consolidation or cross-referencing.

- 3.2.2. the presence of a substantial disparity between the value received by the homeowner and the fair market value of the property at the time of the transaction;
 - 3.2.3. the fact that the homeowner retained possession of the property;
 - 3.2.4. the fact that the homeowner reserved or was assured an option to repurchase, retain or regain title to the property;
 - 3.2.5. the fact that the homeowner continued to pay real estate taxes on the property;
 - 3.2.6. the fact that the homeowner continued to pay or to be liable for other encumbrances on the property;
 - 3.2.7. the fact that the homeowner made post-conveyance improvements to the property; or
 - 3.2.8. the nature of the parties and their relationship prior to and after the conveyance.
- 3.3. Parol evidence shall be admissible to prove that a transaction is an equitable mortgage.
- 3.4. The grantee of a deed or conveyance that is deemed to be an equitable mortgage is deemed to be a mortgagee and may not evict the homeowner nor cause the homeowner to quit involuntarily, other than by foreclosure pursuant to the procedures of state law, nor may the grantee transfer or encumber any interest in the property. Any such transfer or encumbrance is void as to anyone but a bona fide purchaser or lender.
- 3.5. A transaction deemed to be an equitable mortgage must comply with all applicable state and federal laws governing mortgages in property covered by this Act.
- 3.6. The provisions of this Chapter are in addition to and do not preclude any rights or remedies relating to equitable mortgages under common law.

4. Foreclosure Rescue Transactions.

- 4.1. All foreclosure rescue transactions are conclusively deemed to be equitable mortgages subject to Section 3 without further proof of the elements of that Section.
- 4.2. All deeds or other conveyances transferring title to property from a homeowner pursuant to a foreclosure rescue transaction shall carry the statement on the face of the deed or conveyance: “This property is subject to the Foreclosure Rescue Fraud Prevention Act.”
- 4.3. If the grantee records any deed or other conveyance transferring title from the homeowner pursuant to a foreclosure rescue transaction, the grantee shall also document and record with the County Recorder’s office any legal or equitable interest that the homeowner retains in the title of the property as described in Section 2.3.3. Failure to comply with sections 4.2 or 4.3 shall not affect the homeowner’s rights and remedies under this Chapter.
- 4.4. Unfair foreclosure rescue transactions are unlawful, void and a violation of _____.⁸ A foreclosure rescue transaction is unfair if it meets any of the following criteria:
 - 4.4.1. The grantee has violated Section 3.4 or 3.5;
 - 4.4.2. The grantee fails to pay the homeowner consideration amounting to at least 82 percent of the fair market value of the property. Consideration includes only those payments set forth in Section 5.6.1.
 - 4.4.3. The grantee fails to verify that the homeowner has or is likely to have a reasonable ability to make any payments required under the foreclosure rescue transaction and to pay for the subsequent reconveyance back to the homeowner of the full title previously held by homeowner, based upon consideration of the homeowner’s current and expected income, current obligations, employment status, and other financial resources (other than the homeowner’s equity in the

⁸ Fill this space with a reference to the state statute prohibiting unfair and deceptive acts and practices, if it applies to such transactions. If it does not, it should be amended to cover these transactions and to ensure that there is a private cause of action to enforce it.

property that is the subject of the transaction), as verified by documentation of all sources of income and corroborated by independent verification.

4.4.3.1. There is a rebuttable presumption that the grantee has not verified reasonable payment ability if the grantee has not obtained documents other than a statement by the homeowner of assets, liabilities and income.

4.4.3.2. There is a rebuttable presumption that a homeowner has a reasonable ability to pay if the grantee demonstrates that at the time the foreclosure rescue transaction is consummated, the homeowner's total monthly debts, including amounts owed under the transaction, do not exceed fifty percent of the homeowner's monthly gross income; and the grantee follows the residual income guidelines established in 38 C.F.R. § 36.4337(e) and VA Form 26-6393 or their successors.

4.4.4. The homeowner's cost to repurchase or to reacquire title to the property exceeds the consideration paid to the homeowner as set forth in section 5.6.1 by more than 10% if the repurchase is exercised within 24 months of the sale, by more than 15% if the purchase is exercised more than 24 but within 36 months after the sale, or by more than 18% if the repurchase is exercised more than 36 months after the sale.

4.4.5. The homeowner remains liable for an existing mortgage loan on the property.

4.4.6. The transaction, restructured as an equitable mortgage pursuant to Section 5, is a mortgage referred to in 15 U.S.C. § 1602(aa) [the Home Owner's Equity Protection Act] and its implementing regulations; or

4.4.7. The foreclosure rescue transaction is otherwise unfair, deceptive, or commercially unreasonable.

4.4.8. The criteria set forth in this subsection are for purposes of identifying unfair foreclosure rescue transactions and shall not limit a homeowner's damages against the grantee of an unfair foreclosure rescue transaction.

5. **Reformation of Equitable Mortgage.**

5.1. **Voidable Deed.** A deed or other conveyance that is deemed an equitable mortgage is voidable, except as to a bona fide purchaser or bona fide lender, and may be reformed into an equitable mortgage at any time while the homeowner remains in

possession of the property or within three months after the homeowner's loss of possession of the property other than by way of foreclosure by a party other than the grantee.

- 5.2. **Demand to Return Title.** The homeowner may void a deed or conveyance that is deemed an equitable mortgage pursuant to Section 3 or 4.1 and demand that the grantee reform the transaction into an equitable mortgage within the time set forth in Section 5.1 by giving written notice to the grantee or his or her successor in interest. The notice need not take any particular form and, however expressed, is effective if it indicates the intention of the homeowner to retain or regain title to the property.
- 5.3. **Recording of Demand to Return Title.** If the transaction is a foreclosure rescue transaction the homeowner may record the demand to return title with the County Recorder's office of the county in which the property is located, within the time set forth in Section 5.1. In order to be recorded, the notice shall contain the name of the homeowner and the grantee, shall particularly describe the property, and shall cite this Act. The demand to return title shall expire and shall have no effect on the rights of a subsequent purchaser or lender if the homeowner has not recorded a lis pendens within 30 days after recording the demand to return title.
- 5.4. **Obligation to Return Title.** Within 20 calendar days after receipt of a demand to return title, the grantee shall reconvey title to the homeowner, subject to any equitable mortgage pursuant to 5.5 and 5.6 but free and clear of any encumbrances other than tax or utility obligations for which the homeowner would have been responsible had title not been transferred.
- 5.5. **No Prior Tender Required; Recording of Equitable Mortgage.** The homeowner's right to void the deed or other conveyance and demand return of the title, and the grantee's obligation to return title, may not be conditioned on the homeowner's repayment of any funds. The recording of the reconveyance may be accompanied by a Notice of Equitable Mortgage asserting a mortgage in the amount due pursuant to Section 5.6 as follows:

“Notice of Equitable Mortgage.⁹ Notice is hereby given that _____ hereby asserts an equitable mortgage of \$_____ against this property pursuant to the Foreclosure Rescue Fraud Prevention Act.”

⁹ States should confirm that this notice conforms to the terminology used in that state.

If the amount of the equitable mortgage asserted by the grantee does not conform to the requirements of Section 5.6, the homeowner may bring an appropriate action to dispute it in court.

5.6. **Obligations Under the Equitable Mortgage.** If the grantee has paid any money to or on behalf of the homeowner, that money shall be deemed and held an equitable mortgage as follows:

5.6.1. The following shall be deemed the principal of the equitable mortgage:

5.6.1.1. Any money paid to the homeowner;

5.6.1.2. Any money paid on behalf of the homeowner that reduced the homeowner's legal obligations secured by the property to persons unaffiliated with the grantee; and

5.6.1.3. Any money paid on behalf of the homeowner to a person unaffiliated with the grantee that was necessary to prevent a foreclosure of the property.

5.6.2. All other fees, charges, interest or other costs paid by the homeowner as part of the transaction or for which the homeowner is obligated shall be treated as interest and charges on a loan of money secured by a lien on a home under state and federal law. If the equitable mortgage is an unfair foreclosure rescue transaction as defined in this Act, all such fees, charges, interest or other costs are void and must be refunded by the grantee to the homeowner.

5.6.3. Any payments that the homeowner has made in connection with the transaction deemed to be an equitable mortgage, including but not limited to any fees, charges, interest, rent, or other payments, shall be deemed payments on the equitable mortgage for purposes of state and federal law.

5.6.4. The balance of the equitable mortgage shall be further reduced by any damages or statutory penalties owed by the grantee to the homeowner under this section or any other state or federal law governing the transaction.

5.7. **Payment of the Equitable Mortgage.**

5.7.1. After the grantee has complied with Section 5.4, the homeowner shall either tender the full balance of the equitable mortgage to the grantee within 120 days, or make monthly payments to the grantee for one year in an amount based on a 30-year amortization of the amount due pursuant to Section 5.6.1, followed by payment of the remaining balance in full. Until paid, the balance on the equitable mortgage accrues interest at the legal rate¹⁰ from the date of the grantee's compliance with Section 5.4. The court shall not shorten the time for tender or condition the grantee's obligations under Section 5.4 on tender by the homeowner.

5.7.2. The homeowner's failure to repay the balance of the equitable mortgage shall not invalidate the voiding of the deed or conveyance nor the reconveyance of the property. If the homeowner fails to repay the equitable mortgage as set forth in Section 5.7.1, the grantee may recover the balance of the equitable mortgage by way of foreclosure pursuant to the procedures of state law.

6. **Actions for damages or equitable relief.** A homeowner may bring an action for the recovery of damages, declaratory or equitable relief for a violation of this Act. The court may award to a prevailing homeowner actual damages plus reasonable attorneys' fees, costs and expenses. The court may increase the award to an amount not to exceed three times the homeowner's actual damages if the court deems such award proper. Any action brought pursuant to this Act shall be commenced within six years after the date of the alleged violation; provided, however, that a court may grant relief to void or otherwise reverse transfer of title from the homeowner only if the action is filed within the time set forth in Section 5.1.

7. **Stay of Eviction Action.**

7.1. A court hearing an eviction action against the homeowner must stay the eviction action, without imposition of a bond, if the homeowner has commenced an action asserting a violation of this Act, or has made a prima facie case that the eviction plaintiff is merely a mortgagee of an equitable mortgage and has no right to evict. Any court with jurisdiction over claims related to the equitable mortgage or foreclosure rescue transaction may issue a stay of any eviction action on the same grounds.

7.2. A prima facie case consists of a showing that the homeowner conveyed title to the property while the homeowner was in foreclosure or default; that the homeowner

¹⁰ States should confirm whether their laws establish a legal rate of interest and whether another rate is more appropriate. In some states, the legal rate is inordinately high for a mortgage and the federal prime rate or some other rate would be more appropriate.

retained possession of the property subsequent to conveying title; and that the homeowner was given or assured an opportunity to retain or regain title to or possession of the property. Parol evidence is admissible to make this showing.

7.3. The stay expires upon the latter of:

7.3.1. the failure of the homeowner to commence an action in a court of competent jurisdiction pursuant to this Act within 90 days of the issuance of the stay, or

7.3.2. the issuance of an order lifting the stay by a court hearing claims related to the equitable mortgage or foreclosure rescue transaction.

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